

Fastener Distributor Index – August 2018

Written by R.W. Baird analyst David J. Manthey, CFA 9/6/18



Key Takeaway:

The seasonally adjusted FDI for August was 62.5, decelerating m/m vs. July's 69.2 reading. Selling conditions mirrored this overall deceleration, with the seasonally adjusted sales index coming in at a 74.7 (vs. July 89.6). Qualitative commentary, however, was more consistent with the prior month, including continued concerns over tariffs and the potential for a loss of momentum. The six-month outlook generally remains favorable and was essentially unchanged vs. last month, although the Forward-Looking Indicator rebounded some to 63.4 (July 60.1).

Key Points:

About the Fastener Distributor Index (FDI). The FDI is a monthly survey of North American fastener distributors, conducted by the **FCH Sourcing Network**, with **Baird**, and support from the **National Fastener Distributors Association**. It offers insights into current industry trends/outlooks. Similarly, the Forward-Looking Indicator (FLI) is based on a weighted average of four forward-looking inputs from the FDI survey. This indicator is designed to provide directional perspective on future expectations for fastener market conditions. As diffusion indexes, values above 50.0 signal strength, while readings below 50.0 signal weakness. Over time, results should be directly relevant to **Fastenal (FAST)** and broadly relevant to other industrial distributors such as **W.W. Grainger (GWW)** and **MSC Industrial (MSM)**.

August FDI moderates vs. peak levels. The seasonally adjusted August FDI (62.5) decelerated vs. July's 69.2 reading, still strong in absolute terms but nonetheless meaningfully lower vs. last month's very bullish reading. In the August survey, 63% of respondents indicated sales were "better" relative to seasonal expectations vs. 68% in July. This produced a seasonally adjusted sales index of 74.7 (July was a record at 89.6). Pricing was higher among a large majority of respondents, with 84% seeing pricing gains y/y vs. 79% in July. The resulting FDI pricing index of 92.2 strengthened m/m and modestly exceeded the previous record high set in June (90.7). Regarding customer inventories, a majority of respondents view inventory levels as in line with expectations (59% of responses), while 38% believe customers' inventories are too low. This compares to 74% in line and 24% too low in July.

FLI rebounds in August. The seasonally adjusted FLI came up moderately m/m, registering 63.4 vs. 60.1 in July, with three of the four forward-looking inputs in the FDI improving. More broadly, a 63.4 reading suggests market conditions are likely to remain favorable, likely pointing to FDI readings similar to August in the near term.

Manufacturing employment down slightly. Hiring sentiment was relatively unchanged this month among survey respondents. 38% of respondents saw higher employment levels in August relative to seasonal expectations vs. 35% in July, while 59% saw employment as in line (unchanged vs. July). The resulting FDI Employment Index was 67.2 vs. 64.7 last month. Recall, the July US jobs report was a bit weaker than expected with +157,000 jobs added (~190,000 expected), with the unemployment rate dropping to 3.9% (vs. June 4.0%). July's largest gains were registered in professional and business services, manufacturing, and healthcare and social assistance. Manufacturing employment continues to trend upwards (+37,000 jobs in July), with most of the gains again coming from durable goods manufacturing. As of July, total number of manufacturing jobs added over the past year now stands at +327,000. Average hours per work week for manufacturing employees were unchanged at 40.9 hours. *The August jobs report is scheduled for release on Friday, September 7.*

Respondents express some caution in commentary. The overall tone of qualitative commentary was again more cautious this month, with respondents expressing some tariff-related uncertainty, and the potential for a loss of momentum. For example, one respondent commented, "The lack of a consistent trade policy is a negative." Another noted, "Can't imagine this trend continuing, but if it does we certainly won't complain." Inventory was again in focus this month as well, "We have noticed that some of the Master Distributors are short on inventory that they normally stock in a single location. We are having to get it from other warehouse. Not picking on any one Master Distributor, we are seeing this with several different ones." Quantitatively, survey data continues to point to relatively stable momentum expected through 2018, with 47% of respondents expecting higher activity levels over the next six months and 41% expecting similar activity, with the percentage of respondents expecting higher activity remaining steady around ~50% over the past five months.

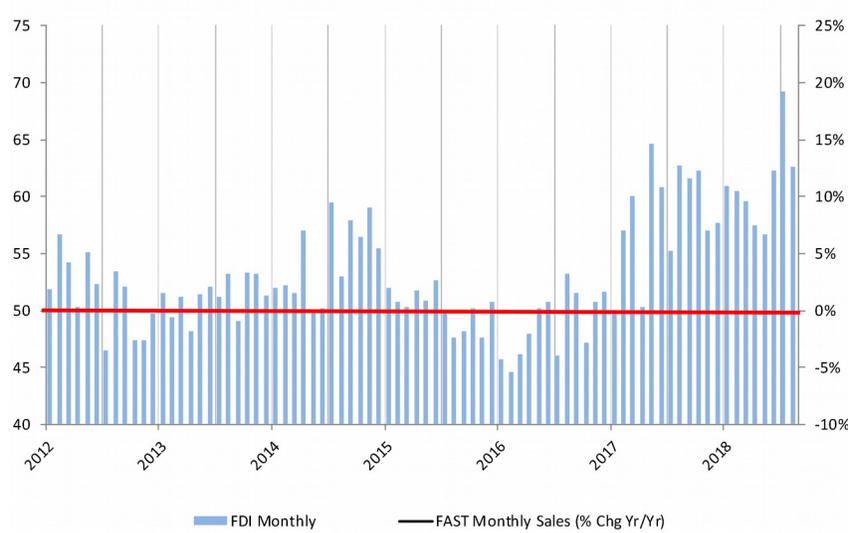
Fastenal reported +12.0% July daily sales growth, exactly matching our estimate, reflecting sequential daily sales growth slightly below average historical m/m trends. Underlying "core" growth (excluding foreign exchange) was +12.2%, the 14th straight month of double-digit growth. Fasteners again saw solid growth at +10.2% y/y. Looking forward, we view the August FDI results as a mixed read-through for FAST August daily sales, and model +12.0% growth y/y. This is slightly below historical m/m trends, as FAST's August has two additional selling days m/m. Based on FDI data and other research inputs, we expect continued solid top-line trends across public industrial distributors during 2018, with Fastenal y/y daily sales growth expected to remain in the double-digits through year-end. *FAST is scheduled to report August daily sales growth on Friday, September 7.*

Fastener Distribution Trends: August 2018

FASTENER DISTRIBUTION AT A GLANCE										
July 2018										
	----- Index Values -----								Direction	Rate of Change
	Aug	Jul	Jun	May	Apr	Mar	Feb	Jan		
PMI (Manufacturing Sector)	61.3	58.1	60.2	58.7	57.3	59.3	60.8	59.1	Growing	Faster
FDI (Fastener Sector)	61.7	65.8	62.5	59.4	59.8	61.2	58.4	64.8	Growing	Slower
FDI (Seasonally Adjusted)	62.5	69.2	62.3	56.6	57.4	59.5	60.4	60.8	Growing	Slower
Sales (SA)	74.7	89.6	74.2	61.2	63.0	70.1	74.2	72.7	Growing	Slower
Forward-Looking (SA)	63.4	60.1	62.0	58.8	58.9	59.9	58.3	64.7	Growing	Faster
(Other Metrics; NSA)										
Employment	67.2	64.7	68.5	60.7	59.4	62.5	62.2	66.7	Growing	Faster
Supplier Deliveries	70.3	83.8	77.8	73.2	71.9	69.6	64.9	66.7	Growing	Slower
Respondent Inventories	59.4	55.9	50.0	57.1	53.1	60.7	59.5	56.1	Growing	Faster
Customer Inventories	32.8	39.7	33.3	37.5	37.5	35.7	40.5	34.8	Declining	Faster
Pricing, month-to-month	76.6	82.4	83.3	75.0	73.4	76.8	68.9	68.2	Growing	Slower
Pricing, year-to-year	92.2	89.7	90.7	87.5	89.1	85.7	78.4	86.4	Growing	Faster
6-Month Outlook - August				Higher	Same	Lower				
				47%	41%	13%				
<p><i>FDI and Pricing are diffusion indexes. At 50, the performance of the category listed met expectations. A reading above 50 suggests the category outperformed expectations, while a reading below 50 suggests the category underperformed expectations.</i></p>										

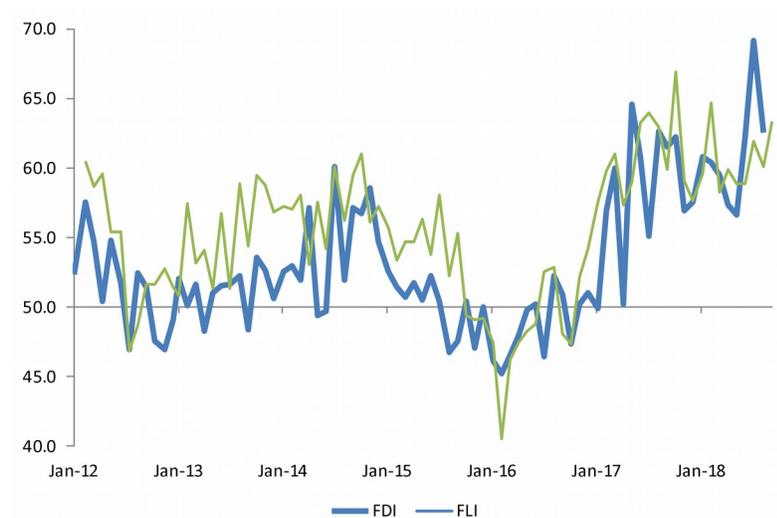
Source: Baird, FCH Sourcing Network, Institute for Supply Management

Fastener Distributor Index (FDI); Seasonally Adjusted



Source: Baird, FCH Sourcing Network, Company reports

1-Month Lagged FDI vs. FLI (Both Seasonally Adjusted)



Source: Baird, FCH Sourcing Network

Risk Synopsis

Fastenal: Risks include economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

Industrial Distribution: Risks include economic sensitivity, pricing power, online pressure/competitive threats, global sourcing, and exposure to durable goods manufacturing.

Appendix – Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are as of 9/5/2018.

Fastenal Company (FAST-\$59.09-Neutral)
 W.W. Grainger Inc. (GWW-\$355.62-Neutral)
 MSC Industrial Direct Co. Inc (MSM-\$87.58-Neutral)
 (See recent research reports for more information)





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